1120-FSC/inst./1990

# 1990

Department of the Treasury
**Internal Revenue Service**

# Instructions for Form 1120-FSC

## U.S. Income Tax Return of a Foreign Sales Corporation

*(Section references are to the Internal Revenue Code unless otherwise noted.)*

**Paperwork Reduction Act Notice.**—We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us this information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

The time needed to complete and file this form and related schedule will vary depending on individual circumstances. The estimated average times are:

| Form | Recordkeeping | Learning about the law or the form | Preparing and sending the form to IRS |
|---|---|---|---|
| 1120-FSC | 89 hrs., 26 min. | 15 hrs., 35 min. | 34 hrs., 31 min. |
| Sch. P (1120-FSC) | 10 hrs., 2 min. | 18 min. | 28 min. |

If you have comments concerning the accuracy of these time estimates or suggestions for making this form and related schedule more simple, we would be happy to hear from you. You can write to both the **Internal Revenue Service,** Washington, DC 20224, Attention: IRS Reports Clearance Officer, T:FP; and the **Office of Management and Budget**, Paperwork Reduction Project (1545-0935), Washington, DC 20503. **DO NOT** send the tax form to either of these offices. Instead, see General Instruction D3 for information on where to file it.

## General Instructions

### A. Purpose of Form

Form 1120-FSC is used to report income, gains, losses, deductions, and credits of a foreign sales corporation **(FSC).** It is also used to figure the FSC's income tax liability. If a refund is due, Form 1120-FSC may be used to claim it.

### B. Definition of a FSC

Section 922(a) defines a FSC as a corporation that has met **all** of the following tests:

**1.** It must be a corporation created or organized under the laws of a "qualifying foreign country" or a "U.S. possession."

A "qualifying foreign country" is a foreign country that meets the exchange of information requirements of section 927(e)(3)(A) or (B). As of July 15, 1987, the Treasury Department had certified the following countries as having met the requirements of section 927(e)(3)(B): Australia, Austria, Barbados, Belgium, Canada, Cyprus, Denmark, Egypt, Finland, France, Germany, Iceland, Ireland, Jamaica, Korea, Malta, Morocco, the Netherlands, New Zealand, Norway, Pakistan, Phillipines, Sweden, and Trinidad & Tobago. (See Notice 87-52, 1987-2 C.B. 362 and Notice 87-53, 1987-2 C.B. 363.)

A "U.S. possession" is defined in section 927(d)(5) so as to include: Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Virgin Islands of the United States.

**2.** It must have no more than 25 shareholders at any time during the tax year.

**3.** It must not have preferred stock outstanding at any time during the tax year.

**4.** During the tax year, it must maintain an office in a "qualifying foreign country" (defined above) or a "U.S. possession" (defined above) and maintain a set of permanent books of account at that office. It must also maintain at a location in the U.S. the books and records required under section 6001 to sufficiently establish the amount of gross income, deductions, credits, or other matters required to be shown on its tax return.

**5.** At all times during the tax year, it must have at least one director who is not a resident of the U.S.

**6.** It must not be a member, at any time during the tax year, of a controlled group of which a DISC is a member.

**7.** Its tax year must conform to the tax year of the principal shareholder who, at the beginning of the FSC's tax year, has the highest percentage of voting power. If two or more shareholders have the highest percentage of voting power, the FSC must elect a tax year that conforms to that of any such shareholder. See section 441(h).

**8.** It must have elected to be a FSC or small FSC (defined below) by filing **Form 8279,** Election To Be Treated as a FSC or as a Small FSC, at the time and in the manner provided in section 927(f)(1) **and** it must have kept the election in effect for the tax year.

**Small FSC.**—Section 922(b) defines a small FSC as a corporation that: **(1)** has elected small FSC status (by filing Form 8279 at the time and in the manner provided in section 927(f)(1)) and has kept it in effect for the tax year; **and (2)** is not a member, at any time during the tax year, of a controlled group that includes a FSC (unless such other FSC is also a small FSC).

A small FSC is exempt from the foreign management and foreign economic process requirements (outlined in General Instructions C2 and C3 below) regarding its eligibility to treat a portion of its income as foreign trading gross receipts. Any foreign trading gross receipts of a small FSC for the tax year that exceed $5,000,000 are not to be taken into account in determining its exempt foreign trade income. The $5,000,000 limit is reduced if the small FSC has a short tax year and it may be reduced if the small FSC is a member of a controlled group that contains other small FSCs. See Regulations section 1.921-2(b) for more information.

### C. Special Tax Treatment of a FSC

A FSC is not taxed on its "exempt foreign trade income." Section 923 defines "exempt foreign trade income" as the gross income of a FSC attributable to "foreign trading gross receipts" (defined below). The percentage of foreign trade income that is exempt from taxation is computed differently for income determined under the "administrative pricing rules" (see the Schedule P instructions for details) and income determined without regard to the administrative pricing rules. (These percentages are computed on Schedule E and are carried over to the computation of taxable income (or loss) on Schedule B.) See section 923(a)(4) for a special rule for foreign trade income allocable to a cooperative. See section 923(a)(5) for a special rule for military property.

**1. Foreign Trading Gross Receipts.**—A FSC is treated as having foreign trading gross receipts (defined in section 924) only if it has met certain foreign management and foreign economic process requirements. (See General Instructions C2 through C4 below for definitions and rules for these requirements.)

Foreign trading gross receipts do **not** include:

**a.** Certain "excluded receipts" (defined in section 924(f)).

**b.** "Investment income" (defined in section 927(c)).

**c.** "Carrying charges" (defined in section 927(d)(1)).

**2. Foreign Management Requirements.**—A FSC (other than a small FSC) is treated as having foreign trading gross receipts for the tax year only if the management of the FSC during the year takes place outside the U.S. These management activities include:

**a.** Meetings of the board of directors and meetings of the shareholders.

**b.** Disbursement of cash, dividends, legal and accounting fees, salaries of officers, and salaries or fees of directors out of the principal bank account.

**c.** Maintaining the principal bank account at all times during the tax year.

**Meetings of directors and meetings of the shareholders.**—All meetings of the board of directors of the FSC and all meetings of the shareholders of the FSC that take place during the tax year must take place outside the U.S. Only meetings that are formally convened as meetings of the board of directors or as shareholder meetings are taken into account. If the participants in a meeting are not all physically present in the same location, the location of the meeting is determined by the location of the persons exercising a majority of the voting power (including proxies) participating in the meeting. In addition, all such meetings must comply with the local laws of the foreign country or U.S. possession in which the FSC was created or organized. The local laws determine whether a meeting must be held, when and where it must be held (if it is

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held at all), who must be present, quorum requirements, use of proxies, etc.

**Principal bank accounts.**—See General Instruction B1 for definitions of "qualifying foreign country" and "U.S. possession." See Regulations section 1.924(c)-1(c) for more information regarding principal bank accounts.

**3. Economic Process Requirements.**—A FSC (other than a small FSC) has foreign trading gross receipts from any transaction only if certain economic processes with respect to such transaction take place outside the U.S. Section 924(d) and Regulations section 1.924(d)-1 set forth the rules for determining whether a sufficient amount of the economic processes of a transaction takes place outside the U.S. Generally, a transaction will qualify if the FSC satisfies two different requirements:

**a.** Participation outside the U.S. in the sales portion of the transaction, and

**b.** Satisfaction of either the 50% or the 85% foreign direct cost test.

The activities comprising these economic processes may be performed by the FSC or by any other person acting under contract with the FSC.

**a. Participation outside the U.S. in the sales portion of the transaction.**—Generally, the requirement of section 924(d)(1)(A) is met with respect to the gross receipts of a FSC derived from any transaction if the FSC has participated outside the U.S. in the following "sales activities" relating to such transaction:

(1) Solicitation (other than advertising),

(2) Negotiation, and

(3) Making of the contract.

(1) "Solicitation (other than advertising)" refers to any communication (by any method, including, but not limited to, telephone, telegraph, mail, or in person) by the FSC, at any time during the 12-month period immediately preceding the execution of a contract relating to the transaction to a specific, targeted customer or potential customer, that specifically addresses the customer's attention to the product or service which is the subject of the transaction. Activities that would otherwise constitute advertising (such as sending sales literature to a customer or potential customer) will be considered solicitation if the activities are not taken into account as advertising under the foreign direct costs tests. An exception to this rule is provided for second mailings in Regulations section 1.924(e)-1(a)(1).

(2) "Negotiation" refers to any communication by the FSC to a customer or potential customer aimed at an agreement on one or more of the terms of a transaction, including, but not limited to, price, credit terms, quantity, or time or manner of delivery. Negotiation does not include the mere receipt of a communication from a customer (such as an order) that includes terms of a sale.

(3) "Making of a contract" refers to performance by the FSC of any of the elements necessary to complete a sale, such as making an offer or accepting an offer. Acceptance of an unsolicited bid or order is considered the "making of a contract" even if no solicitation or negotiation occurred with respect to the transaction. The written confirmation by the FSC to the customer of an oral or written agreement which confirms variable contract terms, such as price, credit terms, quantity, or time or manner of delivery, or specifies (directly or by cross-reference) additional contract terms, will be considered the making of a contract. A written confirmation is any confirmation expressed in writing, including a telegram, telex, or other similar written communication.

**Grouping transactions.**—Generally, the "sales activities" described above are to be applied on a transaction-by-transaction basis. However, a FSC may make an annual election (in Item P(1) on page 2 of Form 1120-FSC) to apply any of the "sales activities" on the basis of a group. See Regulations section 1.924(d)-1(c)(5) for details.

**b. Satisfaction of either the 50% or 85% foreign direct cost test.**—For the gross receipts of a transaction to qualify as foreign trading gross receipts, the foreign direct costs incurred by the FSC attributable to the transaction must equal or exceed 50% of the total direct costs incurred by the FSC attributable to the transaction. Direct costs are those costs attributable to the activities described in the five categories of section 924(e). Instead of satisfying the 50% foreign direct cost test described above, the FSC may incur foreign direct costs attributable to activities described in each of two of the section 924(e) categories that equal or exceed 85% of the total direct costs incurred by the FSC attributable to the activity described in each of the two categories. If no direct costs are incurred by the FSC in a particular category, that category is not taken into account for purposes of determining whether the FSC has met either the 50% or 85% foreign direct cost test.

"Direct costs" are costs that are incident to and necessary for the performance of any activity described in section 924(e). Direct costs include the cost of materials that are consumed in the performance of the activity, and the cost of labor which can be identified or associated directly with the performance of the activity (but only to the extent of wages, salaries, fees for professional services, and other amounts paid for personal services actually rendered, such as bonuses or compensation paid for services on the basis of a percentage of profits). Direct costs also include the allowable depreciation deduction for equipment or facilities (or the rental cost for the use thereof) that can be specifically identified or associated with the activity, as well as the contract price of an activity performed on behalf of the FSC by a contractor.

"Total direct costs" means all of the direct costs of any transaction attributable to activities described in any paragraph of section 924(e). For purposes of the 50% foreign direct cost test of section 924(d)(1)(B), total direct costs are determined based on the direct costs of all activities described in all of the paragraphs of section 924(e). For purposes of the 85% foreign direct cost test of section 924(d)(2), however, the total direct costs are determined separately for each paragraph of section 924(e).

"Foreign direct costs" means the portion of the total direct costs of any transaction that is attributable to activities performed outside the U.S. For purposes of the 50% foreign direct cost test, foreign direct costs are determined based on the direct costs of all activities described in all of the paragraphs of section 924(e). For purposes of the 85% foreign direct cost test, however, foreign direct costs are determined separately for each paragraph of section 924(e).

For more details, see Regulations section 1.924(d)-1(d).

Be sure to check one or both of the boxes (in Item P(2) on page 2 of Form 1120-FSC) to indicate how the FSC met the "foreign direct costs" requirement described above.

**Grouping transactions.**—Generally, the foreign direct cost tests under Regulations section 1.924(d)-1(d) are to be applied on a transaction-by-transaction basis. However, the FSC may make an annual election (in Item P(3) on page 2 of Form 1120-FSC) to apply the foreign direct cost tests on a customer, contract, or product or product line grouping basis. Any groupings used must be supported by adequate documentation of performance of activities and costs of activities relating to the groupings used. See Regulations section 1.924(d)-1(e) for details.

**Exception for foreign military property.**—The economic process requirements do not apply to any activities performed in connection with foreign military sales except those activities described in section 924(e). See Regulations section 1.924(d)-1(f) for details.

**4. Section 925(c) Requirement.**—In order to use the administrative pricing rules to determine the FSC's (or small FSC's) profit on a transaction or group of transactions, the FSC must perform (or have another person acting under contract to it perform) all of the economic process activities relating to the transaction or group of transactions. All of the direct and indirect expenses relating to the performance of those activities must be reflected on the books of the FSC and on Form 1120-FSC. Under Temporary Regulations section 1.925(a)-1T(b)(2)(ii), an election may be made to include on the FSC's books all expenses, other than cost of goods sold, that are necessary to compute combined taxable income for the transaction or group of transactions.

## D. Filing Form 1120-FSC

**1. Who Must File.**—You must file Form 1120-FSC if your corporation elected, by filing Form 8279, to be treated as a FSC or small FSC and the election is still in effect.

**2. When To File.**—File Form 1120-FSC by the 15th day of the 3rd month after the end of the tax year.

**Extensions.**—File **Form 7004,** Application for Automatic Extension of Time To File Corporation Income Tax Return, to request an automatic 6-month extension of time to file Form 1120-FSC.

**Period covered.**—File the 1990 return for calendar year 1990 and fiscal years that begin in 1990 and end in 1991. For a fiscal year, fill in the tax year space at the top of the form.

**Note:** *The 1990 Form 1120-FSC may also be used if: (1) the FSC has a tax year of less than 12 months that begins and ends in 1991; and (2) the 1991 Form 1120-FSC is not available by the time the FSC is required to file its return. However, the FSC must show its 1991 tax year on the 1990 Form 1120-FSC and incorporate any tax law changes that are effective for tax years beginning after December 31, 1990.*

**Amended return.**—To correct any error on a Form 1120-FSC already filed, file a revised Form 1120-FSC and write "Amended" at the top of the form.

**Final return.**—If the corporation ceased to exist during the tax year, write "Final Return" at the top of the form.

**Change in address.**—**Form 8822,** Change of Address, may be filed to notify the IRS of a change of address that occurs after the return is filed.

**3. Where To File.**—File Form 1120-FSC with the Internal Revenue Service Center, Philadelphia, PA 19255.

**4. Signature.**—The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or any other corporate officer (such as tax officer) authorized to sign. A receiver, trustee, or assignee must sign and date any return required to be filed on behalf of a corporation.

If a corporate officer filled in Form 1120-FSC, the Paid Preparer's space under "Signature of officer" should remain blank. If someone prepares Form 1120-FSC and does not charge the corporation, that person should not sign the return. Certain others who prepare Form 1120-FSC should not sign. For example, a regular, full-time employee of the corporation, such as a clerk, secretary, etc., should not sign.

Generally, anyone who is paid to prepare Form 1120-FSC must sign the return and fill in the other blanks in the Paid Preparer's Use Only area of the return.

A preparer that is required to sign the return MUST:

- Complete the required preparer information.
- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give a copy of Form 1120-FSC to the taxpayer in addition to the copy filed with IRS.

## E. Figuring and Paying the Tax

### 1. Accounting

**a. Accounting methods.**—Taxable income must be computed using the method of accounting regularly used in keeping the FSC's books and records. In all cases, the method adopted must clearly reflect taxable income. See section 446.

A member of a controlled group cannot use an accounting method that would distort any group member's income, including its own. For example, a FSC acts as a commission agent for property sales by a related corporation that uses the accrual method and pays the FSC its commission more than 2 months after the sale. In this case, the FSC should not use the cash method of accounting because that method would materially distort its income.

Generally, a FSC is required to use the accrual method of accounting if its average annual gross receipts are more than $5,000,000. See section 448(c). A FSC changing to the accrual method because of this provision must complete **Form 3115,** Application for Change in Accounting Method, and attach it to Form 1120-FSC for the year of change. The FSC must also show on a statement accompanying Form 3115 the period over which the section 481(a) adjustment will be taken into account and the basis for that conclusion. See section 448 and Temporary Regulations sections 1.448-1T(g) and 1.448-1T(h) for more information. Include the amount reportable as income in 1990 under section 481(a) on line 16, Schedule F, page 4.

Unless the law specifically permits otherwise, a FSC may change the method of accounting used to report taxable income in earlier years (for income as a whole or for any material item) only by first getting consent on Form 3115. Also see **Pub. 538,** Accounting Periods and Methods.

The percentage of completion method, including the look-back method under section 460(b), is generally the only permissible method of accounting for long-term contracts entered into on or after July 11, 1989.

Certain contracts, including real property construction contracts, may continue to be accounted for under the permissible methods of accounting for long-term contracts under prior law. However, an election can be made not to recognize income under a long-term contract and not to take into account any costs allocable to the long-term contract if less than 10% of the estimated total contract costs have been incurred as of the end of the tax year. See section 460(b)(5) for more details. An election to use the 10% method will apply to all long-term contracts entered into during the tax year the election is made and to any later tax year.

See section 460; Notice 87-61, 1987-2 C.B. 370; Notice 88-66, 1988-1 C.B. 552; and Notice 89-15, 1989-1 C.B. 634 for more information.

**b. Change in accounting period.**—Generally, before changing an accounting period, a FSC must obtain the Commissioner's approval (Regulations section 1.442-1) by filing **Form 1128,** Application to Adopt, Change, or Retain a Tax Year. Also see Pub. 538.

**Note:** *In general, the tax year of a FSC must be the same as the tax year of that shareholder (or group of shareholders with the same 12 month tax year) who has the highest percentage of voting power. (See section 441(h)(1).)*

### 2. Rounding Off to Whole-Dollar Amounts

A FSC may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

### 3. Payment of Tax Due

A FSC must pay the tax due in full when it files its tax return, but not later than the 15th day of the 3rd month after the end of the tax year. The method for payment of the tax due depends upon whether the FSC has an office or place of business in the U.S.

**a.** FSCs that **do not** maintain an office or place of business in the U.S. must pay the tax due directly to the IRS (i.e., do not use the depositary method of tax payment described in **b** below). The tax may be paid by check or money order, payable to the Internal Revenue Service. To help ensure proper crediting to your account, write your employer identification number, "Form 1120-FSC," and the tax period to which the payment applies on your check or money order. Enclose the payment when you file Form 1120-FSC with the Internal Revenue Service Center, Philadelphia, PA 19255.

**b.** FSCs that **do** maintain an office or place of business in the U.S. must pay the tax due using the depositary method. Under this method, the FSC deposits its income tax payments (and estimated tax payments) with a Federal Tax Deposit Coupon **(Form 8109)**. In doing so, be sure to darken the "1120" box on the coupon. Make these tax deposits with either a financial institution qualified as a depositary for Federal taxes or the Federal Reserve bank or branch servicing the geographic area where the FSC's office or place of business in the U.S. is located. Do not submit deposits directly to an IRS office; otherwise, the FSC may be subject to a failure to deposit penalty. Records of deposits will be sent to the IRS for crediting to the FSC's account. See the instructions contained in the coupon book (Form 8109) for more information.

To help ensure proper crediting to your account, write your employer identification number, "Form 1120-FSC," and the tax period to which the deposit applies on your check or money order.

To get more deposit coupons, use the reorder form **(Form 8109A)** provided in the coupon book.

A penalty may be imposed for failure to deposit the required amount of tax. See section 6656.

For more information concerning deposits, see **Pub. 583**, Taxpayers Starting a Business

**4. Backup Withholding.**— If the FSC has had income tax withheld from any payment it received because, for example, it failed to give the payer its correct employer identification number, it may claim a credit on Form 1120-FSC for the total amount withheld. This type of withholding is called "backup withholding." Show the amount withheld in the blank space in the righthand column between lines 1 and 2h, page 1, and label the amount as "backup withholding." Also include the amount in the total for line 2h.

**Note:** *"Backup withholding" does not include amounts reportable on line 2g for taxes paid or withheld at source.*

**5. Estimated Tax.**—Generally, a FSC must make estimated tax payments if it can expect its estimated tax (income tax minus credits) to be $500 or more. Use **Form 1120-W,** Corporation Estimated Tax, as a worksheet to compute estimated tax. Foreign corporations that maintain an office or place of business in the U.S. must use the deposit coupons (Forms 8109) in making deposits of estimated tax.

If the FSC overpaid estimated tax, it may be able to get a "quick refund" by filing **Form 4466**, Corporation Application for Quick Refund of Overpayment of Estimated Tax. The overpayment must be both: **(1)** at

least 10% of the expected income tax liability, and **(2)** at least $500. To apply, file Form 4466 after the end of the tax year, but before the 16th day of the 3rd month thereafter, and before Form 1120-FSC is filed.

### F. Interest and Penalties

A FSC may be subject to interest and penalty charges if the FSC files a late return or fails to pay tax when due unless it can show that the failure to file or pay was due to reasonable cause and not willful neglect.

**1. Interest.**—Interest is charged on taxes not paid by the due date, even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**2. Late Filing of Return.**—A FSC that fails to file its return when due (including extensions of time for filing) may be subject to a penalty of 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is more than 60 days late is the smaller of the tax due or $100.

**3. Late Payment of Tax.**—The penalty for late payment of taxes is usually ½ of 1% of the unpaid tax for each month or part of a month the tax is unpaid. The penalty cannot exceed 25% of the amount due. This penalty may also apply to any additional tax not paid within 10 days of the date of the notice and demand for payment.

**4. Underpayment of Estimated Tax.**—A FSC that fails to make estimated tax payments when due may be subject to an understatement penalty for the period of underpayment. In general, to avoid the estimated tax penalty, the FSC must make estimated tax payments of at least the smaller of 90% of the tax shown on the return, or 100% of its prior year's tax. See section 6655 for details and exceptions.

**Form 2220,** Underpayment of Estimated Tax by Corporations, is used to determine whether the FSC owes the penalty and to figure the amount of the penalty. Generally, a FSC does not have to file this form since the IRS can figure the amount of any penalty and bill the FSC for it. However, you must complete and attach Form 2220 even if the FSC does not owe the penalty if: **(a)** the annualized income or adjusted seasonal installment method is used, or **(b)** the FSC is a "large corporation" computing its first required installment based on the prior year's tax. If you attach Form 2220, be sure to check the box on line 3 at the bottom of page 1 of Form 1120-FSC and enter the amount of any penalty on that line.

**5. Other Penalties.**—There are also penalties that can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6662 and 6663.

A FSC may also be subject to a penalty (under section 6686) of $100 for each instance it fails to furnish the information required under section 6011(c), up to a maximum of $25,000. This penalty will not apply if the FSC can show that the failure to furnish the required information was due to reasonable cause.

### G. Other Forms, Returns, Schedules, and Statements That May Be Required

**1. Forms, Returns, and Schedules**

**Forms 1042** and **1042S,** Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; and Foreign Person's U.S. Source Income Subject to Withholding.—Use these forms to report and transmit withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations to the extent such payments or distributions constitute gross income from sources within the U.S. (see sections 861 through 865). For more information, see sections 1441 and 1442, and **Pub. 515,** Withholding of Tax on Nonresident Aliens and Foreign Corporations.

**Form 1096**, Annual Summary and Transmittal of U.S. Information Returns.

**Form 1098**, Mortgage Interest Statement.—This form is used to report the receipt from any individual of $600 or more of mortgage interest in the course of the FSC's trade or business for any calendar year.

**Forms 1099-DIV, INT, MISC,** and **R.**—These are some of the information returns that must be filed to report certain payments, such as dividends and interest. For more information, see the **Instructions for Forms 1099, 1098, 5498, and W-2G.**

**Form 5471**, Information Return of U.S. Persons With Respect to Certain Foreign Corporations.—This form may have to be filed by certain officers, directors, or U.S. shareholders of a FSC.

Form 5471 does not have to be filed when the FSC is organized. However, this form may be required with respect to subsequent changes in ownership (see section 6046 and the related regulations). Provided that a Form 1120-FSC is filed, a Form 5471 need not be filed to satisfy the requirements of section 6038 (see Temporary Regulations section 1.921-1T(b)(3) for more information). However, if the FSC is involved in other than FSC activities, Form 5471 and the applicable schedules may have to be filed.

**Form 5472,** Information Return of a Foreign or Foreign-Owned Corporation Engaged in a U.S. Trade or Business.—A FSC that is engaged in a trade or business in the U.S. that is "controlled" by a foreign person must file Form 5472 if the FSC had any of the "reportable transactions" listed below with a related person.

**Control.**—For purposes of who must file Form 5472, a FSC is considered to be controlled by a foreign person if it is owned, directly or indirectly, by a foreign person who owns at least:

**a.** 25% of the total voting power of all classes of stock entitled to vote, or

**b.** 25% of the total value of all classes of stock.

Furthermore, if a FSC is controlled (using the test just described) by another corporation, which in turn is controlled by a foreign person, it is treated as being controlled by such foreign person. In determining control for purposes of section 6038A, the constructive ownership rules of section 318(a) apply, except that 10% is substituted for 50% in applying section 318(a)(2)(C).

**Reportable Transactions.**—The following is a list of transactions reportable on Form 5472:

**a.** Sales and purchases of stock in trade (inventory);

**b.** Sales and purchases of tangible property other than stock in trade;

**c.** Rents and royalties paid and received (other than amounts reported in item **d** below);

**d.** Sales, purchases, and amounts paid and received as consideration for the use of intangible property such as copyrights, designs, formulas, inventions, models, patents, processes, trademarks, and other similar property rights;

**e.** Consideration paid and received for technical, managerial, engineering, construction, scientific, or like services;

**f.** Commissions paid and received;

**g.** Amounts loaned and borrowed (other than open accounts resulting from sales and purchases reported under the other items in this list) that arise and are collected in full in the ordinary course of business;

**h.** Interest paid and received; and

**i.** Premiums paid and received for insurance and reinsurance.

**Form 5713**, International Boycott Report.—Used by persons having operations in or related to "boycotting" countries. In addition, persons who participate in or cooperate with an international boycott may have to complete Schedule A or Schedule B and Schedule C of Form 5713 to compute their loss of the following items: the foreign tax credit, the deferral of earnings of a controlled foreign corporation, IC-DISC benefits, and FSC benefits.

**Form 8264**, Application for Registration of a Tax Shelter.—Used by tax shelter organizers to register tax shelters with the IRS, for the purpose of receiving a tax shelter registration number.

**Form 8271**, Investor Reporting of Tax Shelter Registration Number.—Used by taxpayers who have acquired an interest in a tax shelter, which is required to be registered, to report the tax shelter's registration number. Form 8271 must be attached to any tax return (including an application for tentative refund (Form 1139) and an amended return) on which a deduction, credit, loss, or other tax benefit attributable to a tax shelter is taken or any income attributable to a tax shelter is reported.

**Form 8300**, Report of Cash Payments Over $10,000 Received in a Trade or Business.—Generally, this form is used to report the receipt of more than $10,000 in cash or foreign currency in one transaction (or in a series of related transactions). However, transactions that take place entirely outside the U.S. do not have to be reported.

**Form 8810,** Corporate Passive Activity Loss and Credit Limitations.—Closely held FSCs (and FSCs that are personal service corporations) that are subject to the passive activity limitations of section 469 must use this form to compute their allowable passive activity loss. **Note:** *The credits allowed on Form 1120-FSC are not subject to the limits of section 469.*

**Schedule P (Form 1120-FSC),** Transfer Price or Commission.—Complete and attach a separate schedule for each transaction, group of transactions, or aggregate of transactions to which you apply the administrative pricing rules of section 925.

**2. Attachments**

Attach **Form 4136,** Credit for Federal Tax on Fuels, after page 6, Form 1120-FSC. Attach schedules in alphabetical order and other forms in numerical order after the Form 4136.

In order for us to process the return, you must complete every applicable entry space on Form 1120-FSC. Do not attach statements and write "See attached" in lieu of completing the entry spaces on Form 1120-FSC.

If more space is needed on the forms or schedules, attach separate sheets indicating at the top of each attachment the form number or schedule letter of the form or schedule being continued. Also, show the same information called for on the form in the same order as on the printed forms. **Be sure to show totals on the printed forms.** Please use sheets that are the same size as the forms and schedules. Attach these separate sheets after all the schedules and forms. Also, put the corporation's name and employer identification number (EIN) on each sheet.

### H. Filing Requirements of Foreign Personal Holding Companies and Personal Holding Companies

If the FSC is a "foreign personal holding company" (as defined in section 552), Regulations section 1.551-4 requires certain shareholders of the FSC to attach a statement to their returns (i.e., the shareholders' personal returns) containing the information required by section 551(c). Furthermore, section 6035 (and the related regulations) requires certain officers, directors, and shareholders of a foreign personal holding company to file Schedule N (Form 5471) and the appropriate schedules of Form 5471 (see the **Instructions for Form 5471** for additional information).

If the FSC is a "personal holding company" (as defined in section 542) but not a **foreign** personal holding company, it must file Schedule PH (Form 1120) with Form 1120-FSC and must report the personal holding company tax on line 6, Schedule J. See section 542 and Schedule PH (Form 1120) for details.

### I. Tax Treaty Benefits

A FSC may not claim any benefits under any income tax treaty between the U.S. and any foreign country.

## Specific Instructions

**Address.**—Enter the U.S. address where the FSC maintains the records required under section 6001 (see section 922(a)(1)(D)(iii)). Include the suite, room, or other unit number after the street address.

If the Post Office does not deliver mail to the street address and the FSC has a P.O. box, show the P.O. box number instead of the street address.

**Item D. Foreign Country or U.S. Possession of Incorporation.**— See sections 927(d)(5) and 927(e)(3).

**Item E. Employer Identification Number.**—Enter the FSC's EIN. If the FSC does not have an EIN, it should apply for one on **Form SS-4,** Application for Employer Identification Number. You can get this form at most IRS or Social Security Administration offices. Send Form SS-4 to the Internal Revenue Service Center, Philadelphia, PA 19255. If you have not received the EIN by the time for filing Form 1120-FSC, write "Applied for" in the space for the EIN.

**Item F. Total Assets.**—Enter the total assets of the FSC from line 15, column (d), Schedule L. If there are no assets at the end of the tax year, enter the assets as of the beginning of the tax year.

**Item H.**—Items H(9) through H(15) must be completed if the FSC is a member of a controlled group of corporations and the principal shareholder of the FSC that completes Items H(1) through H(8) is not the group member that is the common parent of the group. (For these purposes, the definition of "controlled group" in section 927(d)(4) is to be applied.) If the controlled group files a consolidated tax return, enter the consolidated assets of the group in Item H(15); otherwise, enter only the common parent's assets.

### Schedule A—Cost of Goods Sold Related to Foreign Trading Gross Receipts

Complete Schedule A only for the cost of goods sold deduction related to foreign trading gross receipts reported on lines 1 through 5 of Schedule B.

If the FSC acts as another person's commission agent on a sale, do not enter any amount on Schedule A for the sale.

A small FSC will have to make two separate computations for cost of goods sold if its foreign trading gross receipts exceed the limitation amount on line 6e of Schedule B. In this case, a deduction for cost of goods sold will be figured separately for the income on line 6h of Schedule B, and separately for the income on line 7 of Schedule F. Attach the computation for the cost of goods sold deduction entered on line 18 of Schedule F to Form 1120-FSC.

Also, complete a separate computation for cost of goods sold and other expenses attributable to income reported on line 4 of Schedule F. Attach this schedule to Form 1120-FSC.

Complete lines 1 through 7, column (a) of Schedule A, to show the cost of goods sold for inventory acquired in transactions using the administrative pricing rules. Complete lines 1 through 7, column (b), to show the cost of goods sold for inventory acquired in transactions in which the administrative pricing rules were not used. For details on administrative or nonadministrative pricing rules, see **Schedule P (Form 1120-FSC),** Transfer Price or Commission.

**Section 263A Uniform Capitalization Rules.**—The uniform capitalization rules of section 263A are discussed in the instructions for Schedule G. See those instructions before completing Schedules A and F.

**Line 4a.**—An entry is required on this line only for FSCs that have elected a simplified method of accounting. In the case of FSCs that have elected the simplified production method, additional section 263A costs are generally those costs, other than interest, that were not capitalized or included in inventory costs under the FSC's method of accounting immediately prior to the effective date in Temporary Regulations section 1.263A-1T, but that are now required to be capitalized under section 263A. In the case of taxpayers that have elected a simplified resale method, additional section 263A costs are generally those costs incurred with respect to the following categories: off-site storage or warehousing; purchasing; handling, processing, assembly, and repackaging; and general administrative costs (mixed service costs). Enter on line 4a the balance of section 263A costs paid or incurred during the tax year that were not included on lines 2 and 3. See Temporary Regulations section 1.263A-1T for more information.

**Line 4b.**—Enter on line 4b any costs paid or incurred during the tax year not entered on lines 2 through 4a.

**Line 6.**—See Temporary Regulations section 1.263A-1T for more information on figuring the amount of additional section 263A costs to be capitalized and added to ending inventory.

**Line 8a. Inventory valuation methods.**—Inventories may be valued at: **(1)** cost, **(2)** cost or market value (whichever is lower), or **(3)** any other method approved by IRS that conforms to the provisions of the applicable regulations cited below.

Taxpayers using erroneous valuation methods must change to a method permitted for Federal income tax purposes. Such a change should be made by filing Form 3115. For further details, see Regulations section 1.446-1(e)(3) and Rev. Proc. 84-74, 1984-2 C.B. 736 as modified by Rev. Proc. 88-15, 1988-1 C.B. 683.

On line 8a, check the method(s) used for valuing inventories. Under "lower of cost or market," the term "market" generally applies to normal market conditions where there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For more requirements, see Regulations section 1.471-4.

Inventory may be valued below cost when the merchandise is: **(1)** unsalable at normal prices, or **(2)** unusable in the normal way because the goods are "subnormal" (i.e., because of damage, imperfections, shop wear, etc.) within the meaning of Regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price, minus direct cost of disposition (but not less than scrap value) if such a price can be established. See Regulations section 1.471-2(c) for more requirements.

If this is the first year the "Last-in First-out" **(LIFO)** inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method provided in section 472, attach **Form 970,** Application To Use LIFO Inventory Method, or a statement with the information required by Form 970. Also check the LIFO box on line 8b. Enter the amount or percent

of total closing inventories covered under section 472 on line 8c. Estimates are acceptable.

If the FSC changed or extended its inventory method to LIFO and had to "write-up" opening inventory to cost in the year of election, report the effect of this write-up as income (as appropriate in Schedule F, line 16) proportionately over a 3-year period that begins in the tax year the election was first made. See section 472(d).

## Additional Information Required on Page 2, Form 1120-FSC

**Item L.**—See section 542 for definition of "personal holding company." See section 552 for definition of "foreign personal holding company." See General Instruction H for filing requirements and other details if the FSC meets the definition of either.

**Items N(3) and O(2)(b).**—See General Instruction B1 for definitions of "qualifying foreign country" and "U.S. possession."

**Item O.**—All FSCs (except small FSCs) must complete these questions. For more information, see "Foreign Management Requirements" in General Instruction C2.

**Item P.**—All FSCs (except small FSCs) must complete Item P(2) to indicate how they met the "foreign direct costs" requirement of section 924(d) with respect to all transactions that generated foreign trading gross receipts reported on lines 1 through 5 of Schedule B. Also, they must complete Item P(1) and/or Item P(3) to make an election to use either of the annual grouping election(s) indicated. See General Instruction C3 for details.

## Schedule B—Taxable Income

Schedule B provides for the computation of taxable income from all sources.

### Part I

Part I provides for the computation of income attributable to foreign trade income. Income and expenses on lines 1 through 15 are reported in column (a) if the administrative pricing rules were used in the transaction that produced the income.

Report in column (b) all foreign trade income from all transactions in which the administrative pricing rules were not used. Attach a schedule showing the computation of the taxable amount. Include only the taxable portion on line 16 of Schedule B.

**Lines 1 through 5.**—Enter foreign trading gross receipts as defined in section 924(a) and General Instruction C1.

Report commission income on line 1 or 2 based on the sale, lease, or rental of property on which such commission arose.

**Line 5.**—If the 50% of gross receipts test of section 924(a)(5) is **not** met, the FSC's gross receipts that would have otherwise qualified under that section are to be reported on line 16, Schedule F, and not here on line 5, Schedule B.

**Lines 6b through 6h.**—See section 924(b)(2)(B) for the rules regarding the determination of the limitation on the amount of foreign trading gross receipts that a FSC may take into account in determining its exempt foreign trade income.

**Line 6f.**—If commission income is reported on line 1 or 2 of Schedule B, total receipts for purposes of line 6f are figured as follows:

1. Enter total of columns (a) and (b), line 6a, Schedule B . _____
2. Enter total commission income reported on line 1 or 2, Schedule B . . . . . _____
3. Line 1 less line 2 . . . . . _____
4. For the commissions reported on line 2 above, enter total gross receipts for the sale, lease, or rental of property on which the commissions arose. (Section 927(b)(2)) . . . _____
5. Add lines 3 and 4. Enter on line 6f, Schedule B . . . . . _____

**Line 6h.**—When making the line 6h allocation, allocate only the commission income attributable to the gross receipts on line 4 above. If the small FSC's foreign trading gross receipts for the tax year (line 6f) exceed its allowable limitation (line 6e), the small FSC may select the gross receipts to which the limitation is allocated. In such case, allocate the line 6g foreign trading gross receipts (which, in this case, is the line 6e limitation amount since it is smaller than the line 6f amount) between columns (a) and (b) of line 6h based on whether you used the administrative pricing rules for the gross receipts you selected. See Regulations section 1.921-2(b)(4).

**Line 7.**—Enter the deduction for cost of goods sold from line 7, Schedule A, page 2.

### Part II

**Line 19a. Net operating loss deduction.**—The net operating loss (**NOL**) deduction is the amount of the NOL carryovers and carrybacks that can be deducted in the tax year. See section 172(a). If this deduction is taken, explain its computation on an attached schedule.

Generally, a FSC may carry an NOL back to each of the 3 tax years preceding the year of the loss and carry it over to each of the 15 tax years following the year of the loss. FSCs that are personal service corporations are not permitted to carry back an NOL to or from any tax year to which a section 444 election applies.

A FSC may carry back 10 years the part of the NOL attributable to a product liability loss. See section 172(b)(1)(I). See Regulations section 1.172-13(c) for the required statement that must be attached to Form 1120-FSC when claiming the 10-year carryback on product liability losses.

There is also an available election to carry an NOL over to just each of the 15 years following the year of the loss. The election may be made by attaching a statement to Form 1120-FSC, but only if the return is filed on time (including extensions). The election is irrevocable. Section 172(b)(1) describes types of losses for which the 15-year carryover period does not apply.

After applying the NOL to the first tax year to which it may be carried, the portion of the loss the FSC may carry to each of the remaining tax years is the excess, if any, of the loss over the sum of the modified taxable income for each of the prior tax years to which the FSC may carry the loss. See section 172(b).

If there is a carryback of an NOL, net capital loss, or an unused credit, file **Form 1139,** Corporation Application for Tentative Refund, within 12 months after the close of the tax year for a "quick refund" of taxes. See section 6411.

**Caution:** Do not attach Form 1139 to Form 1120-FSC. Mail it in a separate envelope and file it with the Internal Revenue Service Center, Philadelphia, PA 19255.

See section 172 for special rules, limitations, and definitions pertaining to NOL carrybacks and carryovers. Also see **Pub. 536,** Net Operating Losses.

See section 382 for the limitation on the amount of taxable income of a loss corporation for any tax year ending after a post-1986 ownership change that may be offset by pre-change NOL carryovers. Also see Temporary Regulations section 1.382-2T(a)(2)(ii), which requires that a loss corporation file an information statement with its income tax return for each tax year that it is a loss corporation.

See section 384 for the limitation on the use of preacquisition losses of one corporation to offset recognized built-in gains of another corporation.

**Line 19b. Dividends-received deduction.**—A FSC may be entitled to a deduction for dividends it receives from other corporations. See the instructions for the dividend worksheet on page 7 to figure the allowable dividends-received deduction. Attach the dividend worksheet you prepare to Form 1120-FSC.

## Schedule E—Percentages To Be Used in Figuring Exempt Foreign Trade Income

For purposes of the "Note" at the top of Schedule E, Form 1120-FSC, a C corporation is a corporation that is not an S corporation. Shareholders other than C corporations are individuals, partnerships, S corporations, trusts, and estates.

Use lines 2a through 2d to figure the exemption percentage for foreign trade income that was determined without regard to the administrative pricing rules (see section 923(a)(2)).

Use lines 3a through 3d to figure the exemption percentage for foreign trade income that was determined by using the administrative pricing rules (see section 923(a)(3)).

## Schedule F—Nonexempt Foreign Trade Income and Nonforeign Trade Income

### Part I

Enter nonexempt foreign trade income and related expenses in Part I.

**Line 2.**—Enter FSC income that resulted from the FSC's cooperation with an international boycott. See Form 5713 for reporting requirements for any FSC with operations in or related to a boycotting country. See section 927(e)(2).

**Line 3.**—Enter any amount of illegal payments, bribes, or kickbacks that the FSC paid directly or indirectly to government officials, employees, or agents. See section 927(e)(2).

**Line 5.**—See the instructions for lines 4a, 4b, and 6 of Schedule A before completing this line.

| Dividends and Dividends-Received Deduction Worksheet | (a) Dividends received | (b) % | (c) Dividends-received deduction: (a) × (b) |
|---|---|---|---|
| 1. Dividends from less-than-20%-owned domestic corporations that are subject to the 70% deduction (other than debt-financed stock) | | 70 | |
| 2. Dividends from 20%-or-more-owned domestic corporations that are subject to the 80% deduction (other than debt-financed stock) | | 80 | |
| 3. Dividends on debt-financed stock of domestic and foreign corporations (section 246A) | | See Inst. | |
| 4. Dividends on certain preferred stock of less-than-20%-owned public utilities | | 41.176 | |
| 5. Dividends on certain preferred stock of 20%-or-more-owned public utilities | | 47.059 | |
| 6. Dividends from less-than-20%-owned foreign corporations that are subject to the 70% deduction | | 70 | |
| 7. Dividends from 20%-or-more-owned foreign corporations that are subject to the 80% deduction | | 80 | |
| 8. Total dividends-received deduction—Add lines 1 through 7. See instructions for limitation. Enter result here and on line 19b, Schedule B | | | |
| 9. Other dividends from foreign corporations not included on lines 3, 6, and 7 | | | |
| 10. Foreign dividend gross-up (section 78) | | | |
| 11. Other dividends | | | |
| 12. Total dividends—Add amounts on lines 1 through 11. Enter here and on line 9, Schedule F | | | |

**Part II**

Enter the taxable portion of gross income of the FSC that is **not** derived from foreign trading gross receipts. This type of income includes amounts specifically excluded from foreign trade income by law (line 7); investment type income (lines 8 through 12); income from property that is subsidized, deemed in short supply, or destined for use in the U.S. (lines 13 and 14); amounts from transactions that did not meet the foreign economic process tests (line 15); and other nonforeign trade income (line 16). For more details, see sections 924(f) and 927(a)(2) and (3).

**Line 9.**—Complete the dividend worksheet above to figure the amount of dividend income to report on line 9. Attach the dividend worksheet you prepare to Form 1120-FSC.

**Line 18.**—Enter the deductions allocated or apportioned to income on lines 7 through 16. Attach to Form 1120-FSC a schedule listing each type of deduction. Show deductions related to cost of goods sold separately. See the instructions for lines 4a, 4b, and 6 of Schedule A before completing this line.

**Passive activity limitations.**—Section 469 generally limits the deduction of passive activity losses for closely held FSCs and FSCs that are personal service corporations. See section 469 and the instructions for Form 8810 for details. **Note:** *The credits allowed on Form 1120-FSC are not subject to the limits of section 469.*

## Instructions for Dividends and Dividends-Received Deduction Worksheet Above

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the FSC is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account.

### Column (a) Instructions

**Line 1.**—Enter dividends (except those received on debt-financed stock acquired after July 18, 1984—see section 246A) that are received from less-than-20%-owned domestic corporations subject to income tax and that are subject to the 70% deduction under section 243(a)(1).

For dividends received from a regulated investment company, see section 854 for the amount subject to the 70% deduction.

So-called dividends or earnings received from mutual savings banks, etc., are really interest. Do not treat them as dividends.

**Line 2.**—Enter dividends (except those received on debt-financed stock acquired after July 18, 1984) that are received from 20%-or-more-owned domestic corporations subject to income tax and that are subject to the 80% deduction under section 243(c).

**Line 3.**—Enter dividends on debt-financed stock acquired after July 18, 1984, that are received from domestic and foreign corporations subject to income tax and that would otherwise be subject to the dividends-received deduction under section 243(a)(1), 243(c), or 245(a). Generally, debt-financed stock is stock that the FSC acquired by incurring a debt (for example, it borrowed money to buy the stock).

**Line 4.**—Enter dividends received on the preferred stock of a less-than-20%-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 5.**—Enter dividends received on preferred stock of a 20%-or-more-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 6.**—Enter the U.S.-source portion of dividends that are received from less-than-20%-owned foreign corporations and that qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the stock of the foreign corporation by vote and value.

**Line 7.**—Enter the U.S.-source portion of dividends that are received from 20%-or-more-owned foreign corporations and that qualify for the 80% deduction under section 245(a).

**Line 9.**—Enter all other dividends received from foreign corporations that do not qualify for a dividends-received deduction.

**Line 10.**—If the FSC claims the foreign tax credit, the tax that is deemed paid under sections 902 and 960 must be treated as a dividend received from the foreign corporation. (See sections 78 and 906(b)(4).)

**Line 11.**—Include the following:

1. Dividends (other than capital gain dividends and exempt-interest dividends) that are received from regulated investment companies and that are not subject to the 70% deduction.
2. Dividends from tax-exempt organizations.
3. Dividends (other than capital gain dividends) received from a real estate investment trust that qualifies, for the tax year of the trust in which the dividends are paid, under sections 856 through 860.
4. Dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock.

Two situations in which the dividends-received deduction will not be allowed on any share of stock are:

**a.** If the FSC held it 45 days or less (see section 246(c)(1)(A)), or

**b.** To the extent the FSC is under an obligation to make related payments for substantially similar or related property.

5. Any other taxable dividend income not properly reported above (including distributions under section 936(h)(4)). If patronage dividends or per-unit retain allocations are included on line 11, column (a), identify the total of these amounts in a schedule and attach it to Form 1120-FSC.

**Line 3, Columns (b) and (c)**

Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also

see section 245(a) before making this computation for an additional limitation that applies to dividends received from foreign corporations. A schedule showing how the amount on line 3, column (c), was figured must be attached to Form 1120-FSC.

**Line 8, Column (c)**

**Limitation on dividends-received deduction.**—Generally, line 8 of column (c) may not exceed the amount from the worksheet below. However, in a year in which an NOL occurs, this limitation does not apply even if the loss is created by the dividends-received deduction. (See sections 172(d) and 246(b).)

| | |
|---|---|
| **1.** Refigure line 18, Part II, Schedule B (on page 3 of Form 1120-FSC) without regard to any adjustment under section 1059 and without regard to any capital loss carryback to the tax year under section 1212(a)(1) | |
| **2.** Multiply the amount on line 1 by 80% | |
| **3.** Enter the sum of the amounts on lines 2, 5, and 7 of column (c) and the portion of the deduction on line 3 of column (c) that is attributable to dividends received from 20%-or-more-owned corporations | |
| **4.** Enter the lesser of line 2 or line 3. (Do not complete the rest of this worksheet if line 3 is greater than line 2. Instead, enter the amount from this line (line 4 of this worksheet) on line 8 of column (c).) | |
| **5.** Enter the total amount of dividends received from 20%-or-more-owned corporations and included on lines 2, 3, 5, and 7 of column (a) | |
| **6.** Subtract line 5 from line 1 | |
| **7.** Multiply the amount on line 6 by 70% | |
| **8.** Subtract line 3 of this worksheet from line 8 of column (c) | |
| **9.** Enter the lesser of line 7 or line 8 | |
| **10.** Dividends-received deduction after limitation (sec. 246(b)). Add the amounts on lines 4 and 9 and enter on line 8 of column (c) | |

## Schedule G—Deductions Allocated or Apportioned to Foreign Trade Income

### Limitations on deductions

**1. Section 263A uniform capitalization rules.**—The uniform capitalization rules of section 263A require FSCs to capitalize or include in inventory certain costs incurred in connection with the production of real and personal tangible property held in inventory or held for sale in the ordinary course of business. Tangible personal property produced by a taxpayer includes a film, sound recording, videotape, book, or similar property. The rules also apply to personal property (tangible and intangible) acquired for resale. Taxpayers subject to the rules are required to capitalize not only direct costs but an allocable portion of most indirect costs (including taxes) that relate to the assets produced or acquired for resale. Interest expense paid or incurred during the production period of certain property must be capitalized and is governed by special rules. For more information, see Notice 88-99, 1988-2 C.B. 422. The uniform capitalization rules also apply to the production of property constructed or improved by a taxpayer for use in a trade or business or in an activity engaged in for profit.

Section 263A does not apply to personal property acquired for resale if the taxpayer's average annual gross receipts are $10,000,000 or less. It does not apply to timber or to most property produced under a long-term contract. Special rules apply for farmers. The rules do not apply to property that is produced for use by the taxpayer if substantial construction had occurred before March 1, 1986.

In the case of inventory, some of the indirect costs that must be capitalized are administrative expenses; taxes; depreciation; insurance; compensation paid to officers attributable to services; rework labor; and contributions to pension, stock bonus, and certain profit-sharing, annuity, or deferred compensation plans.

The costs required to be capitalized under section 263A are not deductible until the property to which the costs relate is sold, used, or otherwise disposed of by the FSC.

Current deductions may still be claimed for reasonable research and experimental costs under section 174, and mining and exploration and development costs. Temporary Regulations section 1.263A-1T specifies other indirect costs that may be currently deducted and those that must be capitalized with respect to production or resale activities. For more information, see Temporary Regulations section 1.263A-1T.

**2. Transactions between related taxpayers.**—Generally, an accrual basis taxpayer may only deduct business expenses and interest owed to a related party in the year the payment is included in the income of the related party. See sections 163(j) and 267 for limitation on deductions for unpaid expenses and interest.

**3. Business startup expenses.**—Business startup expenses are required to be capitalized unless an election is made to amortize them over a period of 60 months. See section 195.

**Line 1.** Enter only foreign direct costs on lines 1a through 1e. See section 924(e) and Regulations sections 1.924(e)-1T(a) through (e) for definitions and rules on direct activity costs related to foreign trade income.

**Line 4. Depreciation.**—Besides depreciation, include on line 4 the part of the cost (up to $10,000) the FSC elected to expense (under section 179) for certain tangible property placed in service during its tax year beginning in 1990, or carried over from 1989. See the instructions for **Form 4562,** Depreciation and Amortization.

**Line 5. Salaries and wages.**—Enter on line 5 the amount of total salaries and wages paid or incurred for the tax year. Do not include salaries and wages deductible elsewhere on the return, such as amounts included in cost of goods sold, elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement.

**Line 11. Bad debts.**—Enter the total debts that became worthless in whole or in part during the tax year.

**Line 14. Other deductions.**—Attach a separate sheet listing all allowable deductions that are not deductible elsewhere on Form 1120-FSC. Enter the total on this line.

Generally, a deduction may not be taken for the amount of any item or part thereof allocable to a class of exempt income.

Generally, the FSC can deduct only 80% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. In addition, meals must not be lavish or extravagant; a bona fide business discussion must occur during, immediately before, or immediately after the meal; and your employee must be present at the meal. See section 274(k)(2) for exceptions. If the FSC claims a deduction for unallowable meal expenses, it may have to pay a penalty.

Additional limitations apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and **Pub. 463,** Travel, Entertainment, and Gift Expenses, for details.

Generally, a FSC can deduct all other ordinary and necessary travel and entertainment expenses paid or incurred in its trade or business. However, it cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) that is used for an activity that is usually considered entertainment, amusement, or recreation. **Note:** *The FSC may be able to deduct the amount if the expense is treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.*

**Note:** *Do not deduct penalties imposed on a FSC such as those included in General Instruction F.*

## Schedule J—Tax Computation

**Lines 1 and 2.**—Members of a "controlled group" (as defined in section 927(d)(4)) are entitled to one $50,000 and one $25,000 taxable income bracket amount (in that order) on line 2a.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an attached statement) must show the part of the amount in each taxable income bracket apportioned to that member. There are other requirements as well. See Regulations section 1.1561-3(b) for these requirements and for the time and manner of making the consent.

**Equal Apportionment Plan.**—If no apportionment plan is adopted, the members of the controlled group must divide the amount in each taxable income bracket equally among themselves. For example, controlled group AB consists of corporation A and corporation B. They do not elect an unequal apportionment plan. Therefore, both corporation A and corporation B are entitled to $25,000 (one-half of $50,000) in the $50,000 taxable income bracket on line 2a(i) and to $12,500 (one-half of $25,000) in the $25,000 taxable income bracket on line 2a(ii).

**Unequal Apportionment Plan.**—Members of a controlled group may elect an unequal apportionment plan and divide the amount in each taxable income bracket as they

wish. There is no need for consistency among taxable income brackets. Any member of the controlled group may be entitled to all, some, or none of the amount in a taxable income bracket. However, the total amount for all members of the controlled group cannot be more than the total amount in each taxable income bracket.

**Each member of a controlled group must compute the tax as follows (except qualified personal service corporations):**

1. Enter taxable income (line 20, Schedule B) . . . . . _____
2. Enter line 1 or the FSC's share of the $50,000 taxable income bracket, whichever is less . . . . . _____
3. Subtract line 2 from line 1 . _____
4. Enter line 3 or the FSC's share of the $25,000 taxable income bracket, whichever is less . . . . . _____
5. Subtract line 4 from line 3 . _____
6. Enter 15% of line 2 . . . _____
7. Enter 25% of line 4 . . . _____
8. Enter 34% of line 5 . . . _____
9. If the taxable income of the controlled group exceeds $100,000, enter this member's share of the **lesser** of: **(a)** 5% of the excess over $100,000, **or (b)** $11,750. (See instructions for additional 5% tax below.) . _____
10. Total of lines 6 through 9. Enter this amount on line 3, Schedule J . . . . . _____

**Additional 5% tax.** Members of a controlled group are treated as one corporation for purposes of figuring the applicability of the additional 5% tax that must be paid by corporations with taxable income in excess of $100,000. If the additional tax applies, each member of the controlled group will pay that tax based on the part of the amount that is used in each taxable income bracket to reduce that member's tax. (See section 1561(a).) Each member of the group must enter its share of the additional 5% tax on line 2b and attach to its tax return a schedule that shows the taxable income of the entire group as well as how its share of the additional tax was figured.

**Line 3.**—A FSC must compute its tax on its taxable income as follows:

**(1) FSCs that are not qualified personal service corporations (defined below). (Members of a controlled group should see the instructions on page 8 for lines 1 and 2.):**

| If its taxable income (line 20, Schedule B) is: Over— | But not over— | Its tax is: | Of the amount over— |
|---|---|---|---|
| $0 | $50,000 | 15% | $0 |
| 50,000 | 75,000 | $7,500 + 25% | 50,000 |
| 75,000 | 100,000 | 13,750 + 34% | 75,000 |
| 100,000 | 335,000 | 22,250 + 39% | 100,000 |
| 335,000 | ---- | 34% | 0 |

**(2) Qualified personal service corporations:**

**Caution:** If the FSC is a qualified personal service corporation, be sure to check the box on line 3, Schedule J, Form 1120-FSC.

A qualified personal service corporation is taxed at a flat rate of 34% on its taxable income. For this purpose, a qualified personal service corporation is any corporation: **(a)** substantially all of the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and **(b)** at least 95% of the stock of which is owned by employees performing the services, retired employees who had performed the services listed above, any estate of an employee or retiree described above, or any person who acquired the stock of the FSC as a result of the death of an employee or retiree described above, if the acquisition occurred within 2 years of death. See Temporary Regulations section 1.448-1T(e) for details.

**Line 4. Foreign tax credit.**—Generally, a FSC may not claim a foreign tax credit. A FSC may, however, claim a foreign tax credit for any foreign taxes imposed on foreign source non-foreign trade income (Schedule F, Part II) that is treated as effectively connected with a U.S. trade or business under section 921(d).

See Temporary Regulations section 1.921-3T(d)(2) for more details.

**Line 6. Personal holding company tax.**—See General Instruction H.

**Line 7a. Alternative minimum tax.**—Attach **Form 4626,** Alternative Minimum Tax—Corporations, to Form 1120-FSC if the FSC's taxable income or (loss) before the NOL deduction (line 18, Schedule B less line 19b, Schedule B) when combined with its adjustments and tax preference items (including the adjusted current earnings adjustment) totals more than the lesser of: (a) $40,000, or (b) the FSC's allowable exemption amount. See Form 4626 for details.

**Line 7b. Environmental tax.**—The FSC may be liable for the environmental tax if its modified alternative minimum taxable income exceeds $2,000,000. See Form 4626 for details.

**Line 8. Total tax.—Interest on tax deferred under the installment method for certain nondealer installment obligations.** If an obligation arising from the disposition of property to which section 453A applies is outstanding at the close of the year, the FSC must include the interest due under section 453A(c) in the amount to be entered on line 8, Schedule J. Write on the dotted line to the left of line 8, Schedule J, "Sec. 453A(c) interest–$(amount)." Attach a schedule showing the computation.

## Schedule L—Balance Sheets

**Line 5. Tax-exempt securities.**—Include on this line:

**(1)** State and local government obligations, the interest on which is excludible from gross income under section 103(a), and

**(2)** Stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the corporation.

## Schedule M-1—Reconciliation of Income per Books With Income per Return

**Line 5c. Travel and entertainment.**—Include on this line: 20% of meals and entertainment not allowed under section 274(n); expenses for the use of an entertainment facility; the part of business gifts in excess of $25; expenses of an individual allocable to conventions on cruise ships in excess of $2,000; employee achievement awards in excess of $400; the cost of entertainment tickets in excess of face value (also subject to 20% disallowance); the cost of skyboxes in excess of the face value of nonluxury box seats; the part of the cost of luxury water travel not allowed under section 274(m); expenses for travel as a form of education; and other travel and entertainment expenses not allowed as a deduction.

# Codes for Principal Business Activity

These codes for the Principal Business Activity are designed to classify enterprises by the type of activity in which they are engaged, to facilitate the administration of the Internal Revenue Code. Though similar in format and structure to the Standard Industrial Classification (SIC) codes, they should not be used as SIC codes.

Using the list below, enter on page 1, item G(1), the code number for the specific industry group from which the largest percentage of "total receipts" is derived. "Total receipts" means the total of receipts on line 6a, Schedule B, and lines 4 and 17 of Schedule F.

On page 1, items G(2) and G(3), state the principal business activity and the principal product or service that accounts for the largest percentage of total receipts. For example, if the principal business activity is "Wholesale trade: Machinery, equipment, and supplies," the principal product or service may be "Engines and turbines."

## Agriculture, Forestry, and Fishing

*Code*

0400 Agricultural production.
0600 Agricultural services (except veterinarians), forestry, fishing, hunting, and trapping.

## Mining

**Metal mining:**

1010 Iron ores.
1070 Copper, lead and zinc, gold and silver ores.
1098 Other metal mining.
1150 Coal mining.

**Oil and gas extraction:**

1330 Crude petroleum, natural gas, and natural gas liquids.
1380 Oil and gas field services.

**Nonmetallic minerals, except fuels:**

1430 Dimension, crushed and broken stone; sand and gravel.
1498 Other nonmetallic minerals, except fuels.

## Construction

**General building contractors and operative builders:**

1510 General building contractors.
1531 Operative builders.

**1600 Heavy construction contractors.**

**Special trade contractors:**

1711 Plumbing, heating, and air conditioning.
1731 Electrical work.
1798 Other special trade contractors.

## Manufacturing

**Food and kindred products:**

2010 Meat products.
2020 Dairy products.
2030 Preserved fruits and vegetables.
2040 Grain mill products.
2050 Bakery products.
2060 Sugar and confectionery products.
2081 Malt liquors and malt.
2088 Alcoholic beverages, except malt liquors and malt.
2089 Bottled soft drinks, and flavorings.
2096 Other food and kindred products.

**2100 Tobacco manufacturers.**

**Textile mill products:**

2228 Weaving mills and textile finishing.
2250 Knitting mills.
2298 Other textile mill products.

**Apparel and other textile products:**

2315 Men's and boys' clothing.
2345 Women's and children's clothing.
2388 Other apparel and accessories.
2390 Miscellaneous fabricated textile products.

**Lumber and wood products:**

2415 Logging, sawmills, and planing mills.
2430 Millwork, plywood, and related products.
2498 Other wood products, including wood buildings and mobile homes.

**2500 Furniture and fixtures.**

**Paper and allied products:**

2625 Pulp, paper, and board mills.
2699 Other paper products.

**Printing and publishing:**

2710 Newspapers.
2720 Periodicals.
2735 Books, greeting cards, and miscellaneous publishing.
2799 Commercial and other printing, and printing trade services.

*Code*

**Chemicals and allied products:**

2815 Industrial chemicals, plastics materials and synthetics.
2830 Drugs.
2840 Soap, cleaners, and toilet goods.
2850 Paints and allied products.
2898 Agricultural and other chemical products.

**Petroleum refining and related industries (including those integrated with extraction):**

2910 Petroleum refining (including integrated).
2998 Other petroleum and coal products.

**Rubber and misc. plastics products:**

3050 Rubber products: plastics footwear, hose and belting.
3070 Miscellaneous plastics products.

**Leather and leather products:**

3140 Footwear, except rubber.
3198 Other leather and leather products.

**Stone, clay, and glass products:**

3225 Glass products.
3240 Cement, hydraulic.
3270 Concrete, gypsum, and plaster products.
3298 Other nonmetallic mineral products.

**Primary metal industries:**

3370 Ferrous metal industries; misc. primary metal products.
3380 Nonferrous metal industries.

**Fabricated metal products:**

3410 Metal cans and shipping containers.
3428 Cutlery, hand tools, and hardware; screw machine products, bolts, and similar products.
3430 Plumbing and heating, except electric and warm air.
3440 Fabricated structural metal products.
3460 Metal forgings and stampings.
3470 Coating, engraving, and allied services.
3480 Ordnance and accessories, except vehicles and guided missiles.
3490 Misc. fabricated metal products.

**Machinery, except electrical:**

3520 Farm machinery.
3530 Construction and related machinery.
3540 Metalworking machinery.
3550 Special industry machinery.
3560 General industrial machinery.
3570 Office, computing, and accounting machines.
3598 Other machinery except electrical.

**Electrical and electronic equipment:**

3630 Household appliances.
3665 Radio, television, and communication equipment.
3670 Electronic components and accessories.
3698 Other electrical equipment.

**3710 Motor vehicles and equipment**

**Transportation equipment, except motor vehicles:**

3725 Aircraft, guided missiles and parts.
3730 Ship and boat building and repairing
3798 Other transportation equipment, except motor vehicles.

**Instruments and related products:**

3815 Scientific instruments and measuring devices; watches and clocks.
3845 Optical, medical, and ophthalmic goods.
3860 Photographic equipment and supplies.

**3998 Other manufacturing products.**

## Transportation and Public Utilities

*Code*

**Transportation:**

4000 Railroad transportation.
4100 Local and interurban passenger transit.
4200 Trucking and warehousing.
4400 Water transportation.
4500 Transportation by air.
4600 Pipe lines, except natural gas.
4700 Miscellaneous transportation services.

**Communication:**

4825 Telephone, telegraph, and other communication services.
4830 Radio and television broadcasting.

**Electric, gas, and sanitary services:**

4910 Electric services.
4920 Gas production and distribution.
4930 Combination utility services.
4990 Water supply and other sanitary services.

## Wholesale Trade

**Durable:**

5008 Machinery, equipment, and supplies.
5010 Motor vehicles and automotive equipment.
5020 Furniture and home furnishings.
5030 Lumber and construction materials.
5040 Sporting, recreational, photographic, and hobby goods, toys and supplies.
5050 Metals and minerals, except petroleum and scrap.
5060 Electrical goods.
5070 Hardware, plumbing and heating equipment and supplies.
5098 Other durable goods.

**Nondurable:**

5110 Paper and paper products.
5129 Drugs, drug proprietaries, and druggists' sundries.
5130 Apparel, piece goods, and notions.
5140 Groceries and related products.
5150 Farm-product raw materials.
5160 Chemicals and allied products.
5170 Petroleum and petroleum products.
5180 Alcoholic beverages.
5190 Miscellaneous nondurable goods.

## Retail Trade

**Building materials, garden supplies, and mobile home dealers:**

5220 Building materials dealers.
5251 Hardware stores.
5265 Garden supplies and mobile home dealers.

**5300 General merchandise stores.**

**Food stores:**

5410 Grocery stores.
5490 Other food stores.

**Automotive dealers and service stations:**

5515 Motor vehicle dealers.
5541 Gasoline service stations.
5598 Other automotive dealers.

**5600 Apparel and accessory stores.**

**5700 Furniture and home furnishings stores.**

**5800 Eating and drinking places.**

**Miscellaneous retail stores:**

5912 Drug stores and proprietary stores.
5921 Liquor stores.
5995 Other retail stores.

## Finance, Insurance, and Real Estate

*Code*

**Banking:**

6030 Mutual savings banks.
6060 Bank holding companies.
6090 Banks, except mutual savings banks and bank holding companies.

**Credit agencies other than banks:**

6120 Savings and loan associations.
6140 Personal credit institutions.
6150 Business credit institutions.
6199 Other credit agencies.

**Security, commodity brokers and services:**

6210 Security brokers, dealers, and flotation companies.
6299 Commodity contracts brokers and dealers; security and commodity exchanges; and allied services.

**Insurance:**

6355 Life insurance.
6356 Mutual insurance, except life or marine and certain fire or flood insurance companies.
6359 Other insurance companies.
6411 Insurance agents, brokers, and service.

**Real estate:**

6811 Real estate operators and lessors of buildings.
6516 Lessors of mining, oil, and similar property.
6518 Lessors of railroad property and other real property.
6530 Condominium management and cooperative housing associations.
6550 Subdividers and developers.
6599 Other real estate.

**6749 Holding and investment companies except bank holding companies.**

## Services

**7000 Hotels and other lodging places.**

**7200 Personal services.**

**Business services:**

7310 Advertising.
7389 Business services, except advertising.

**Auto repair; miscellaneous repair services:**

7500 Auto repair and services.
7600 Miscellaneous repair services.

**Amusement and recreation services:**

7812 Motion picture production, distribution, and services.
7830 Motion picture theaters.
7900 Amusement and recreation services, except motion pictures.

**Other services:**

8015 Offices of physicians, including osteopathic physicians.
8021 Offices of dentists.
8040 Offices of other health practitioners.
8050 Nursing and personal care facilities.
8060 Hospitals.
8071 Medical laboratories.
8099 Other medical services.
8111 Legal services.
8200 Educational services.
8300 Social services.
8600 Membership organizations.
8911 Architectural and engineering services.
8930 Accounting, auditing, and bookkeeping.
8980 Miscellaneous services (including veterinarians).